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TREASURY FOR LAWRENCE NORTON  
STOCKHOLM FOR FCS

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SUBJECT: ICELAND: GOVT BUYS 75 PERCENT SHARE IN THIRD-LARGEST BANK

11. (U) Summary: The Government of Iceland announced on 29 September that it is taking a majority share in Glitnir Bank, the country's third largest bank. The move follows a frantic round of secret weekend consultations between Prime Minister Haarde, the Central Bank, the heads of all major political parties, and Iceland's leading banks. Under the agreement, the Government will purchase 75 percent of Glitnir at roughly \$878 million. This is the first significant government intervention in the Icelandic economy during the recent crisis and comes after a week of harsh criticism for perceived inaction -- in particular, for not managing to include Iceland in the 24 September exchange agreement between the U.S. Federal Reserve and the central banks of the other Nordic countries and Australia. The immediate result of the bailout was the pre-filing for bankruptcy of a holding company which is interconnected to a large portion of businesses. It appears that Glitnir will be saved, but the domino effect of weakened share prices could still damage the overall economy. End Summary.

12. (U) The Government of Iceland announced on September 29 that it would buy a 75 percent share in the country's third-largest bank, capping a tumultuous week in the economy here. On September 24, the US Federal Reserve announced it was making \$30 billion available to the central banks in Australia, Denmark, Sweden and Norway to ease money markets through an exchange agreement to improve global liquidity. The Central Bank of Iceland came under immediate fire from Icelandic financial experts and the media for not getting itself included in the agreement. After refusing comment for nearly 24 hours, the Central Bank of Iceland issued a statement saying that it had been engaged in talks with the Federal Reserve in the past weeks. According to the statement, the U.S. Fed did not see a reason to make such an agreement with the Central Bank of Iceland at this point, but the possibility of a future agreement has not been ruled out.

13. (U) For most of September, several well-respected economists and leading editorialists have publicly criticized the Central Bank's monetary policy and the GOI's handling of the ever worsening economic situation. Some even called for the resignation of the entire board of governors of the Central Bank. The rapid fall of the Icelandic krona (40 percent since the beginning of 2008) and the news of the exclusion of Iceland from the other Nordic's agreement with the U.S. Federal Reserve only exacerbated the public outcry. This criticism has fueled a growing sentiment that Iceland should explore joining the EU and adopt the euro, with recent opinion polls showing for the first time majority support for exploring the possibility.

14. (U) On September 27, PM Geir Haarde called a meeting with the board of governors at the Central Bank and his economic advisors. When asked, Haarde said he was only familiarizing himself with any developments that had taken place while he had been attending the UNGA in New York. After the meeting he said that such a meeting was

normal and that no big news was about to break. On September 28, Haarde and the Central Bank of Iceland's board of governors held a late-night meeting with executives from Iceland's three main commercial banks, Kaupthing, Landsbanki, and Glitnir and representatives from the Social Democratic Alliance -- the junior party in the coalition government -- and the opposition parties.

¶5. (U) On Monday, September 29 the media announced that the GOI was taking control of Glitnir, the third largest Icelandic bank, buying a 75 percent stake for 600 million euros (approximately \$878 million), more than 6 percent of Iceland's 2007 GDP. This move was a surprise to the general public. All parties involved quickly announced the problem was related to international financial markets and not the management or assets of the bank itself. The Central Bank said Glitnir's asset portfolio and capital position were solid and its loans were good quality; it said it did not intend to keep its stake in Glitnir for an extended period. The Prime Minister held a press conference to echo the Central Bank's sentiments and added that the government must safeguard financial stability. Glitnir said its core operations were robust and CEO Larus Welding had been asked to stay. Glitnir said it had been successful in raising funds this year despite very challenging market conditions, "nonetheless, the events unfolding in international financial markets in the past two weeks have had unforeseen consequences drastically changing the conditions of Glitnir's short-term funding," the bank said in a statement.

¶6. (SBU) Post's contacts at Glitnir confirmed that even bank employees had no idea this was coming. Glitnir's management has told employees that because the bank was very well run and management was not the problem, everyone will probably keep their jobs. The larger concern is for stockholders; because the number of Glitnir's stock had to be increased to provide the state with 75

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percent equity, Glitnir's stock lost even more value than market-induced declines and had dropped 88 percent of its value by the end of the day. The biggest shareholder of Glitnir is Stodir (formerly FL Group and connected with Baugur Group) which just filed for pre-bankruptcy. The ripple effect of one of financial titan Baugur Group's major assets going bankrupt could set off other disruptions in the economy.

¶7. (SBU) Comment: Although the main problem of Glitnir was the inaccessibility to short term-credit caused by the global shortage of liquidity, resolving this has not cured all ills. The news on Glitnir's bailout sent the Icelandic krona to a fresh record low against the euro and caused the value of Glitnir's stock to plunge. Given that in recent years Iceland's economic success has been largely based on leveraged buyouts, the plummeting value of stocks could have drastic consequences throughout the economy.

VAN VOORST